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## SECURITIES AND EXCHANGE COMMISSION

**[Release No. IA–1993; File No. 803–160]**

## Sterling Johnston Capital Management, L.P.; et al.; Notice of Application

November 1, 2001.

**AGENCY:** Securities and Exchange Commission (the ''SEC'').

**ACTION:** Notice of application for exemption under the Investment Advisers Act of 1940 (''Advisers Act'').

*Applicants:* Sterling Johnston Capital Management, L.P. ''SJCM'' and Hirtle Callaghan Trust (''Trust'').

*Relevant Advisers Act Sections:* Exemption requested under section 206A of the Advisers Act from section 205 of the Advisers Act and Advisers Act rule 205–1.

*Summary of Application:* Applicants request an order permitting SJCM and its affiliates to charge a performance fee based on the performance of that portion of a Trust portfolio managed by SJCM (''SJCM Account''). Applicants further request that the order permit them to compute the performance-related portion of the fee using changes in the SJCM Account's gross asset value rather than net asset value.

*Filing Dates:* The application was filed on June 4, 2001, and amended on October 31, 2001.

*Hearing or Notification of Hearing:* An order granting the application will be issued unless the SEC orders a hearing. Interested persons may request a hearing by writing to the SEC's Secretary and serving applicants with copies of the request, personally or by mail. Hearing requests should be received by the SEC by 5:30 p.m. on November 26, 2001, and should be accompanied by proof of service on applicants, in the form of an affidavit or, for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons may request notification of a hearing by writing to the SEC's Secretary.

**ADDRESSES:** Secretary, SEC, 450 5th Street, NW, Washington, DC 20549–0609. Applicants, Sterling Johnston Capital Management, L.P., One Sansome Street, Suite 1800, San Francisco, CA 94104; Hirtle Callaghan Trust, 575 Swedesford Road, Wayne, Pennsylvania 19087.

**FOR FURTHER INFORMATION CONTACT:** Sarah B. Ackerson, Senior Special Counsel at (202) 942–4780 or Jennifer L. Sawin, Assistant Director, at (202) 942–0719 (Division of Investment Management, Office of Investment Adviser Regulation).

**SUPPLEMENTARY INFORMATION:** The following is a summary of the application. The complete application may be obtained for a fee at the SEC's Public Reference Branch.

### Applicants' Representations

1. SJCM is an investment adviser registered under the Advisers Act. The Trust is an open-end management investment company registered under the Investment Company Act of 1940. The Trust was organized by Hirtle, Callaghan & Co. (''Hirtle Callaghan''), an investment adviser registered under the Advisers Act. The Trust is a series company that currently consists of several separate investment portfolios. Shares of the Trust are available only to clients of Hirtle Callaghan or clients of financial intermediaries, such as investment advisers, that are acting in a fiduciary capacity with investment discretion and that have established relationships with Hirtle Callaghan.

2. Hirtle Callaghan serves as a ''manager of managers'' for the Trust. Pursuant to its agreement with the Trust, Hirtle Callaghan is not authorized to exercise investment discretion with respect to the Trust's assets. Hirtle Callaghan is responsible for monitoring the overall investment performance of the Trust's portfolios and the performance of the portfolio managers that manage the Trust's portfolios. Hirtle Callaghan may also from time to time recommend that the Trust's Board of Trustees (the ''Board'') retain additional portfolio managers or terminate existing portfolio managers. Authority to select new portfolio managers and reallocate assets among the portfolio managers, however, resides with the Trust's Board.

3. SJCM, Frontier Capital Management (''Frontier''), and Geewax, Terker & Co. (''Geewax'') provide portfolio management services to the Small Capitalization Equity Portfolio (''Portfolio''), one of several separate investment portfolios that comprise the Trust. Pursuant to a portfolio management agreement, SJCM provides portfolio management services for a portion of the Portfolio's assets that the Trust's Board allocates to SJCM (''SJCM Account''). SJCM, Frontier, and Geewax are assigned responsibility to manage a separate portion of the Portfolio and each acts as though it were advising a separate investment company. Percentage limitations on investments are applied to each portion of the Portfolio without regard to the investments in the other advisers' portions of the Portfolio. When each adviser receives information about portfolio positions from the Trust or its custodian, the adviser generally receives only information about the portion of the Portfolio assigned to it, and not information about the positions held by the Portfolio as a whole. Each adviser generally is responsible for preparing reports to the Trust and the Board only with respect to its discrete portion of the Portfolio.

4. SJCM is not affiliated with Hirtle Callaghan, the Trust or any other investment advisory organization that provides portfolio management and services to the Trust.[1] Services provided to the Trust by SJCM are limited to investment selection for the SJCM Account, placement of transactions for execution and certain compliance functions directly related to such services. SJCM and its affiliates do not act as a distributor or sponsor for the Trust or Portfolio. No member of the Trust's Board is affiliated with SJCM.

5. SJCM currently receives a fee at the annual rate of 0.40 percent of the average daily net assets of the SJCM Account, payable monthly. On October 18, 2000 the Trust's Board and the Trust's disinterested trustees approved an amendment to the portfolio management agreement between SJCM and the Trust under which the existing fee structure would be replaced with a fee structure that includes a performance component. On December 1, 2000 the shareholders of the Portfolio approved the amendment to the agreement.[2] The proposed amendment would become effective on the first day of the month following receipt of an order from the SEC approving the proposed fee schedule. SJCM's fee would be adjusted to reflect the performance of the SJCM Account only after the proposed amendment has been in effect for 12 months (the ''Initial Period'').

6. Under the proposed fee arrangement, at the end of each of the first three quarters of the Initial Period, SJCM would receive a base fee of 0.10

[1] SJCM does not have any affiliates at this time. Future affiliates, if any, will comply with the terms of any order issued by the Commission in connection with this application.

[2] The proxy statement associated with this shareholder meeting specifically informed shareholders that, if approved by the shareholders, the proposed fee would not become effective until receipt of assurances from the SEC that calculating the fee as proposed would not be viewed as inconsistent with the Advisers Act, and that there could be no guarantee that the SEC would give such assurances.

percent of the average daily net assets of the SJCM Account during the quarter (''Base Fee'').[3] At the end of the fourth quarter of the Initial Period, SJCM would receive the Base Fee, plus or minus a performance component multiplied by the average net assets of the SJCM Account during the Initial Period. The performance component (''Performance Component'') would be equal to 25 percent of the difference between (i) the total return of the SJCM Account calculated without regard to expenses incurred in the operation of the SJCM Account (''Gross Total Return'') and (ii) the sum of the total return of the Russell 2000 Growth Index (''Index Return'') plus a performance hurdle of 40 basis points.

7. None of the expenses of the Portfolio, including SJCM's advisory fee, would be deducted from the performance of the SJCM Account for purposes of calculating Gross Total Return. However, Gross Total Return would reflect the effect (*i.e.*, reducing performance) of all applicable brokerage and transaction costs.

8. For each quarter following the fourth quarter of the Initial Period, SJCM would receive the Base Fee, plus or minus 25% of the Performance Component multiplied by the average net assets of the SJCM Account for the immediately proceeding 12-month period, on a ''rolling basis.'' The maximum annual fee payable for any 12-month period would not exceed 80 basis points, or 20 basis points with respect to any quarter (except the fourth quarter of the Initial Period). The minimum fee payable would be zero with respect to any 12-month period or quarter. The maximum and minimum fees were set by the portfolio management agreement between the Trust and SJCM and are not necessary mathematical outcomes of the fee formula.[4]

[3] Applicants may seek in the future to amend the terms of the proposed fee arrangement to provide for a base fee that is calculated at the annual rate of 0.40% of the SJCM Account's average daily net assets. Calculating the base fee at an annual rate would result in the payment to SJCM of a base fee (before any performance adjustment) that is approximately the same as the quarterly base fee payable under the proposed fee arrangement. It is Applicant's position that any such amendment to the proposed fee arrangement would not constitute a material change in the nature of the proposed fee arrangement, or a change in any material fact set forth in this Application and upon which Applicants rely in their analysis of those provisions of the Advisers Act from which relief is hereby requested. Accordingly, it is Applicant's position that any such amendment would not alter Applicant's ability to rely upon any order issued by the Commission pursuant to this Application.

[4] If the aggregate payments made to SJCM with respect to the first 12 month period exceed the performance-adjusted fee to which SJCM would be entitled, the amount of any excess fee would be credited to the Portfolio in subsequent quarters before additional fee amounts would be payable to SJCM. If the portfolio management agreement between the Trust and SJCM is terminated, the Trust would not recoup any outstanding excess fees that had been paid in previous quarters.

**Applicants' Legal Analysis**

1. Section 205(a)(1) of the Advisers Act generally prohibits an investment adviser from entering into any investment advisory agreement that provides for compensation to the adviser on the basis of a share of capital gains or capital appreciation of a client's account.

2. Section 205(b) of the Advisers Act provides a limited exception to this prohibition, permitting an adviser to charge a registered investment company and certain other entities a fee that increases and decreases ''proportionately with the investment performance of the investment company or fund over a specified period in relation to the investment record of an appropriate index of securities prices or such other measure of investment performance as the [SEC] by rule, regulation or order may specify.''

3. Rule 205–1 under the Advisers Act requires that the investment performance of an investment company be computed based on the change in the net (of all expenses and fees) asset value per share of the investment company.

4. Applicants request exemptive relief from section 205 and rule 205–1 of the Advisers Act to permit them to charge the proposed fee (i) applying the proposed fee only to the SJCM Account and not to the Portfolio as a whole, and (ii) computing the Performance Component measured by the change in the SJCM Account's gross asset value, rather than the change in the net asset value of the SJCM Account.

5. Applicants state that Congress, in adopting and amending section 205 of the Advisers Act, and the SEC, in adopting rule 205–1, put into place safeguards designed to ensure that investment advisers would not take advantage of advisory clients.

6. Applicants assert that the SEC required that performance fees be calculated based on the net asset value of the investment company's shares to prevent a situation where an adviser could earn a performance fee even though investment company shareholders did not derive any benefit from the adviser's performance after the deduction of fees and expenses.

7. Applicants state that, unlike traditional performance fee arrangements, SJCM would not receive the Performance Component of its fee unless its management of the SJCM Account has resulted in performance in excess of the Index Return plus a ''performance hurdle'' equal to 40 basis points. Applicants assert that increasing the performance of the Index Return by the 40 basis point hurdle would have an effect similar to deducting SJCM's fees. In the event the Base Fee changes, the performance hurdle also would be changed to match the Base Fee. Applicants state that because the fee structure contains a performance hurdle, the Portfolio's shareholders will have protections similar to those contemplated by the net asset value requirement of rule 205–1.

8. Applicants state that Congress' concern, in enacting the safeguards of section 205, came about because the vast majority of investment advisers exercised a high level of control over the structuring of the advisory relationship. Applicants state that the proposed fee, however, was negotiated actively at arm's length between the parties. Applicants state that SJCM has little, if any, influence over the overall management of the Trust or the Portfolio beyond stock selection. Management functions of the Trust and the Portfolio reside in the Trust's Board. The Trust is directly and fully responsible for supervising the Trust's service providers and monitoring expenses of each of the Trust's portfolios. The Trust's Board is responsible for allocating the assets of the several portfolios among the portfolio managers. SJCM did not sponsor or organize the Trust, or serve as a distributor or principal underwriter of the Trust. SJCM does not own any shares issued by the Trust. No officer, director or employee of SJCM serves as an executive officer or director of the Trust. SJCM is not an affiliated person of Hirtle Callaghan or any other person who provides investment advice with respect to the Trust's advisory relationships (except to the extent that such affiliation may exist by reason of SJCM serving as investment adviser to the Trust).

9. Applicants argue that the proposed fee arrangement satisfies the purpose of rule 205–1 because it was negotiated at arms-length and the Trust does not need the protections afforded by calculating a performance fee based on net assets. Applicants argue that the proposed fee arrangement therefore is consistent with the underlying policies of section 205 and rule 205–1 and that the exemption would be consistent with the protection of investors.

**Applicants' Conditions**

1. If the base fee changes, the performance hurdle will be changed to match the base fee.

2. To the extent SJCM relies on the requested order with respect to advisory arrangements with other investment companies that it advises, these arrangements will meet the following requirements: (i) The investment advisory fee will be negotiated between SJCM, or the applicable affiliate of SJCM, and the investment company or its primary investment adviser; (ii) the fee structure will contain a performance hurdle that is, at all times, no lower than the base fee; (iii) neither SJCM nor any of its affiliates will serve as distributor or sponsor of the investment company; (iv) no member of the board of the investment company will be affiliated with SJCM or SJCM's affiliates; (v) neither SJCM nor any of its affiliates will organize the investment company; and (vi) neither SJCM nor any of its affiliates will be an affiliated person or any primary adviser to the investment company or of any other person who consults or provides advice with respect to the investment company's advisory relationships (except to the extent that SJCM or its affiliates may be affiliated with another portfolio manager by virtue of the fact that SJCM or the affiliate serves as a portfolio manager to the investment company or to another investment company).

For the SEC, by the Division of Investment Management, under delegated authority.

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–45009; File No. SR–CBOE–2001–55]**

## Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Chicago Board Options Exchange, Incorporated To Establish Connectivity Fees for Use of Its New Screen-Based Trading System

October 31, 2001.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder,[2] notice hereby is given that on October 12, 2001, the Chicago Board Options Exchange, Incorporated (''CBOE'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On October 29, 2001, CBOE submitted Amendment No. 1 to the proposed rule change.[3] The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

CBOE is proposing to establish connectivity fees in connection with the establishment of the Exchange's screen-based trading system, known as CBOE*direct.* The text of the proposed rule change is available at the principal office of the Exchange and at the Commission's Public Reference Room.

### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with Commission, CBOE included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received regarding the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. CBOE has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

*A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change*

1. Purpose

CBOE is proposing to establish connectivity fees applicable to the Exchange's new screen-based trading system, CBOE*direct.*[4] These charges relate to the hardware, software, and network costs associated with connecting to the new screen-based trading platform and would be applicable only to members desiring certain types of connectivity to CBOE*direct.* Order-sending firms would be able to route orders to CBOE*direct* via the new connectivity or via existing connections to CBOE's Order Routing System (which serves orders routed to the floor of the Exchange). Members, such as liquidity providers, desiring to connect to CBOE*direct* via the new connectivity would incur set-up charges based on the nature of the connection and the hardware selected. Such members would first choose from two available Application Programming Interfaces (''APIs''): (1) A ''CMI'' API, or (2) a ''FIX'' API. For members that desire a CMI API, additional hardware would be required. There would be three different hardware options available to these users involving different CBOE software and server combinations. Prices for each type are detailed in CBOE's fee schedule. A FIX API connection would involve a $500 charge if the user does not already have appropriate FIX connectivity. All of these set-up charges would be one-time charges.

Connectivity charges also would involve a monthly circuit charge. For members using a CBOE managed network, charges would be based on the bandwidth selected by the user as well as the user's distance from a network POP server. For a member using its own network, a lesser monthly charge would be applicable based on API/hardware configuration.

2. Statutory Basis

CBOE believes that the proposed rule change is consistent with section 6(b) of the Act[5] in general and section 6(b)(4)[6] in particular, in that it is designed to provide for the equitable allocation of reasonable dues, fees, and other charges among CBOE members.

*B. Self-Regulatory Organization's Statement on Burden on Competition*

CBOE does not believe that the proposed rule change would impose any burden on competition not necessary or appropriate in furtherance of purposes of the Act.

*C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others*

No written comments were solicited or received with respect to the proposed rule change.

### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

CBOE represents that the proposed rule change establishes or changes a due, fee, or other charge imposed by the Exchange and, therefore, has become

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Letter from Angelo Evangelou, CBOE, to Michael Gaw, Division of Market Regulation, Commission, dated October 25, 2001 (''Amendment No. 1''). The original filing set forth proposed fees for connectivity charges and excessive requests for quote (''RFQs''). In Amendment No. 1, CBOE withdrew the portion of the filing relating to RFQ fees and stated its intention to resubmit this portion in a separate filing.

[4] The Exchange anticipates that, initially, trading on CBOE*direct* will occur only during extended trading hours for a limited range of products. Separately, CBOE has filed a proposed rule change to adopt certain rules governing trading on CBOE*direct. See* File No. SR–CBOE–00–55.

[5] 15 U.S.C. 78f(b).

[6] 15 U.S.C. 78f(b)(4).